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Grantor Retained Annuity Trusts: The Time is Now!



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With interest rates at record lows, more estate plans are incorporating the use of a Grantor Retained Annuity Trust ("GRAT"). It is an estate planning tool that "divides" the property to be given away into two pieces. The first piece is called the "retained interest," and the second piece is called the "remainder interest". To illustrate, assume that an individual or business owner wants to place \$1,000,000 of marketable securities or closely-held corporate stock into a trust for the benefit of the individual's children but the individual or business owner would like to receive an annual annuity of \$50,000 from the trust for 20 years. The individual or business owner would establish an irrevocable trust and make a gift to that trust of \$1,000,000 of marketable securities or closely-held corporate stock. The trust would provide that the individual or business owner would receive an annual annuity equal to \$50,000 for 20 years and at the end of 20 years the then assets within the trust would be distributable to the beneficiaries of the trust. Under these circumstances the individual or business owner would not be treated as having made a gift of \$1,000,000. Rather, the true amount of the gift would be \$1,000,000 minus the value of the "retained interest" (i.e., the right to receive an annual annuity equal to \$50,000). If the individual or business owner were age 60 upon creation of the trust, the Internal Revenue Code provides that the value of the retained interest for 20 years is \$884,365 and the value of the remainder interest is \$115,635. Thus, the individual or business owner is treated as having made a gift of \$115,635. This can be sheltered from gift tax by applying \$115,635 of the unified credit exemption equivalent.

Failure to survive the fixed term that is set forth in the trust agreement results in the inclusion of the entire fair market value of the trust assets at the date of death in the taxable estate. In other words, in our illustration, the individual or business

owner is gambling on his or her own longevity versus the Internal Revenue Service's actuarial tables. If the individual or business owner loses the gamble, the GRAT accomplishes no tax savings and the estate is merely returned to the same tax position it would have been in if the individual or business owner had not established the GRAT.

A GRAT is often an excellent estate planning technique to pass appreciated assets to the next generation. Key to the planning is the interest rate the IRS uses to value the remainder interest. For June, the interest rate is at a historical low of 1.20%. When valuing the gift component, the IRS assumes that the trust assets will earn 1.20%. The lower the interest rate – the smaller the value of the gift. If the trust assets actually earn more than 1.20% then even more assets will pass to the beneficiaries free of gift or estate taxes. Another important point is the requirement that the individual or business owner survive the trust term.

Below is a chart illustrating the amount of the gift which will have to be recognized if the property is transferred by the individual or business owner in trust for a 5, 10 or 20 year term.

<u>TERM</u>	<u>INTEREST RETAINED</u>	<u>GIFT</u>
5	241,245	758,755
10	468,525	531,475
20	884,365	115,635

There is much uncertainty regarding the potential reduction of the present \$5,000,000 gift tax exemption by year-end. Now is the time to do planning. Contact our Business Group if you should have any questions.

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